

The Australian Workers' Union  
Submission to  
The Australian Bureau of Statistics  
Consumer Price Index Review

12 March 2010

## PRINCIPAL PURPOSE OF THE CONSUMER PRICE INDEX (CPI)

### **1. Should measuring inflation faced by households remain the principal purpose of the CPI in Australia and what is the role of the CPI in the face of emerging community needs?**

AWU Response:

The CPI is an important economic indicator and affects Australian Workers' Union (AWU) members specifically through wages outcomes. In wage negotiations employers and employees use the CPI measure of price inflation to judge current and expected costs of living. Some AWU Enterprise Bargaining Agreements specifically link wage increases over the life of the agreement to the CPI increase over the life of the agreement. Almost all agreements use the CPI as a reference point.

The AWU would prefer to return to an outlays based approach to measuring the CPI because this approach better reflects changes in the purchasing power of money.

- The outlays approach defines the basket of goods and services to be included and their relative importance in terms of the amounts paid by households to gain access to consumer goods and services.
- From 1960 until 1997 the Australian CPI used the outlays approach. A key purpose of the CPI during this period was to provide input into centralised wage and salary determination processes.
  - We note the Department of Social Security Submission to the 13<sup>th</sup> Review of the CPI (April 1997) also advocated that CPI should measure cost of living. Despite the importance of this submission the decision was made to change from the cost of living (the outlays approach) to adopt the current general measure of price inflation for households (the acquisitions approach).

The AWU supports the view that there should be just one measure of the CPI and that adjustments should be made infrequently.

- There is very real risk that government will wish to choose a measure of CPI that will reduce projected CPI indexed pension outlays.

2. **Comment on the usefulness of supplementary indexes such as population subgroup measures. These subgroups are: Employee households; Other government transfer recipient households; Age pensioner households; and Self-funded retiree households**

AWU Response:

The current subgroup measures are not useful to the AWU.

In wage negotiations employers use the CPI because it is widely used as a deflator in other contracts both public and private and is used to set interest rates.

#### COMPILATION FREQUENCY OF THE CPI

3. **Comment on:**
- **whether quarterly release of the CPI still meets user requirements or whether user needs would be better served by a monthly CPI; and**
  - **whether user needs justify the additional costs involved in compiling a monthly CPI.**

AWU Response:

The quarterly release meets AWU needs. We are primarily interested in trends in the inflation outlook and quarterly data are sufficient to pick a “turning point” in inflation.

The CPI is one of the most important statistics prepared by the Australian Bureau of Statistics therefore decisions should not be made on the basis of additional cost.

- The Reserve Bank relies heavily on the CPI to set monetary policy. The Reserve Bank could cover Australian Bureau of Statistics costs through a bank levy.

## EVALUATION OF THE DEPOSIT AND LOAN FACILITIES INDEX

### 4. Comment on:

- **whether financial services paid for indirectly via interest margins are appropriate services for inclusion in the CPI; and**
- **whether the Australian Bureau of Statistics methodology correctly measures the price change for this service.**

AWU Response:

As discussed the AWU prefers the outlays approach to measuring price inflation. The Australian Bureau of Statistics state that the two very important differences between the outlays and the current approach:

- the treatment of owner-occupied housing costs; and
- financial services and the use of credit

#### Owner-occupied housing costs

The treatment of expenditure on owner-occupied housing costs has fuelled much of the debate on the relative merits of the outlays and current approach for the CPI.

Under the current approach, an appropriate measure is the change in prices for the new stock of owner-occupied housing, new renovations and extensions, and other costs incurred (e.g. maintenance costs and council rates). This excludes mortgage interest payments which significantly reduces the usefulness of the CPI as a measure of purchasing power of money.

Under AWU's preferred outlays approach, the CPI measure includes changes in the rate of interest paid on mortgages and other costs incurred.

- Notwithstanding the international prices manual assertion that "...there seems to be little justification for including payments of nominal interest in a CPI, especially in inflationary conditions", Australian workers' high level of household debt means that it is very important that these costs are included in the CPI measurement.
  - Over the last 18 years the total amount of debt owed by Australian households rose almost six-fold to around \$1.1 trillion by September 2008 in real terms (i.e. adjusted to remove the effect of inflation). Most debt was incurred to buy houses. Between 1990 and 2008, debt for investor housing increased from 11% to 27% of all household debt, (Australian Bureau of Statistics Catalogue 4102.0 - Australian Social Trends, March 2009).

#### Financial services and the use of credit

Under the AWU's preferred approach, the CPI measure in the case of financial services and the use of credit is the change in the level of interest paid on a real level of debt.

- The Reserve Bank uses the CPI to set interest rates. The inclusion of interest rates complicates monetary targeting because if the Reserve Bank raises interest rates this causes the housing and financial services index to increase. This might lead the CPI index to rise rather than fall in response to higher rates.
- However, this is not a strong argument against the outlays approach. The Reserve Bank can exclude these components as is currently done in Table 2.
  - The Reserve Bank already makes two adjustments to get trend estimates for the CPI.

### MAINTAINING THE RELEVANCE OF THE CPI

#### **5. Comment on the current frequency of CPI expenditure class weight updates (six yearly).**

AWU Response:

We agree that broad expenditure weights (see Table 1) should be updated every six years.

#### **6. Comment on the importance of, and need for, spatial measures and regional CPIs.**

AWU Response:

AWU members work in remote mining and resource based projects in Western Australia and Queensland.

Despite the low population density in these areas we believe it is important to measure prices.

- Often these regions represent Australia's high growth export regions.
- Remoteness has a significant impact on prices - the Pilbara price index was estimated to be 20% higher than the already expensive Perth in 2007.

Although data exists it is irregular.

- In Western Australian the AWU has been using an annual publication by the WA Department of Local Government and Regional Development "the Regional Prices Index" to obtain CPI information for 21 locations. The final publication in this series was November 2007. However the new WA Department of Regional Development and Lands will publish a biennial spatial study commencing 2011.

- In Queensland the Office of Economic and Statistical Research Queensland Health published “Index of Retail Prices in Queensland Regional Centres” .This publication contains information derived from a survey of regional retail prices of goods and services in selected Queensland cities and towns in May 2006.

The AWU believes that the Australian Bureau of Statistics, as the central agency should coordinate data collection (using state governments’ collection network) to ensure data quality, coverage and time series.

- Establishing a shared database of original price data for as many areas and dates as possible should be a priority.

**Table 1. Percentage Contribution (Weights) used to construct CPI**

Group	Share or weight in shopping trolley
FOOD	16.38
ALCOHOL AND TOBACCO	7.94
CLOTHING AND FOOTWEAR	4.33
HOUSING	11.45
HOUSEHOLD CONTENTS AND SERVICES	10.12
HEALTH	4.74
TRANSPORTATION	14.70
COMMUNICATION	3.60
RECREATION	12.71
EDUCATION	2.94
FINANCIAL AND INSURANCE SERVICES	11.08
EMPLOYEE HOUSEHOLDS ALL GROUPS	100.00

**Table 2 CPI**

	Sep Qtr 2009 to Dec Qtr 2009 %	Dec Qtr 2008 to Dec Qtr 2009 %
<b>Weighted average of eight capital cities</b>	chang e	chang e
Food	1.4	1.9
Alcohol and tobacco	0.5	3.1
Clothing and footwear	0.2	2.1
Housing	0.8	5.5
Household contents and services	0.0	3.6
Health	-0.9	4.7
Transportation	-0.8	1.2
Communication	0.0	0.6
Recreation	1.5	1.1
Education	0.1	5.6
Financial and insurance services	0.7	-6.3
<b>All groups</b>	<b>0.5</b>	<b>2.1</b>
All groups excluding Housing and Financial and insurance services	0.4	2.3